

REPORT OF EXAMINATION
CONTRACTORS BONDING AND INSURANCE COMPANY

Seattle, Washington

As of December 31, 1996



Participating States:
Washington

Contractors Bonding and Insurance Company

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of CONTRACTORS BONDING AND INSURANCE COMPANY of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 1996.

James T. Odiorne, CPA, JD
Deputy Commissioner for Company Supervision
Acting Chief Examiner

9/30/98
Date

Contractors Bonding and Insurance Company

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Contractors Bonding and Insurance Company

Seattle, Washington
April 30, 1998

The Honorable Deborah Senn, Commissioner
Washington Department of Insurance
Insurance Building
P.O. Box 40255
Olympia, WA 98504-0255

Dear Commissioner:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

CONTRACTORS BONDING AND INSURANCE COMPANY

of

Seattle, Washington

hereinafter referred to as "CBIC" or the "Company," at its home office located at 1213 Valley Street, Seattle, Washington 98109. This report is respectfully submitted showing the condition of the Company as of December 31, 1996.

SCOPE

This examination covers the period January 1, 1992 through December 31, 1996 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Insurance Code and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. Additionally, the examiners reviewed and utilized the work papers prepared by the Company's independent auditors to the extent possible.

Contractors Bonding and Insurance Company

INSTRUCTIONS

The examiners reviewed the Company's filed 1996 Annual Statement as part of the statutory examination. The review focused on determining if the Company's Annual Statement was completed in accordance with the Annual Statement Instructions published by the National Association of Insurance Commissioners. The following summarizes the exceptions noted while performing this review and the Company is instructed to correct and comply in future Annual Statement filings, per RCW 48.05.250.

1. Unallocated Loss Expenses Unpaid

A review of Schedule P by the actuarial staff noted that Unallocated Loss Expenses Unpaid were included with the Allocated Loss Expenses Unpaid. The Company is instructed to, beginning with the 1998 Annual Statement, calculate and record in Schedule P appropriate amounts for Unallocated Loss Expenses Unpaid.

RECOMMENDATIONS

The examination developed the following comments or recommendations calculated to prevent non-compliance in the future.

1. Cash

A review of the Board of Directors' Minutes and the list of authorized check signers notes that not all of the authorized check signers have been approved by the Board. It is recommended that the Company submit to the Board annually the list of authorized check signers for review and approval.

2. Cash Receipts

Premiums receipts by mail are opened by the Operations Manager, who endorses the back of the checks and forwards the remittance slip and checks to the Accounting Department. However, the Operations Manager does not maintain a receipt log showing the daily receipts. It is recommended that the Operations Manager run a tape of the checks that are received in the mail and record the total in a Daily Log. The tape should be forward to the Accounting Department along with the remittance slips and checks. The Accounting Department should run a second tape and agree the total to the first tape. Any discrepancies should be investigated and resolved.

3. Conflict of Interest

It is recommended that Officers of the Company submit a signed Conflict of Interest Statement annually.

4. EDP Security

The Company does not periodically review employee's current system and application access to determine if the current level of access is commensurate with job responsibilities. It is recommended that access levels of employees be reviewed annually and updated to ensure that access is appropriate for current job responsibilities.

Contractors Bonding and Insurance Company

HISTORY

Contractors Bonding and Insurance Company was granted a Solicitation Permit on September 25, 1979 and received its Certificate of Authority on October 9, 1979 to transact a surety insurance business in the State of Washington. The Certificate was amended on July 15, 1980 authorizing the transaction of Marine & Transportation, Vehicle, Property and General Casualty insurance. The Company is authorized to do business in each of the fifty (50) states and the District of Columbia.

The Articles of Incorporation were approved by the Insurance Commissioner, State of Washington and were filed with the Secretary of State, State of Washington on September 24, 1979. The Company increased its capitalization from \$2,860,250 to \$3,860,250 on July 21, 1988. On May 9, 1997, subsequent to the examination date, CBIC issued a stock dividend to its sole shareholder, Data and Staff Service Company (DSSC), of 15,000 common shares, \$10 par value, increasing capitalization to \$4,010,250.

In 1994 CBIC began writing other commercial property and casualty lines, focusing on certain niche markets including contractor's general liability where it can capitalize on its knowledge of the construction industry.

MANAGEMENT

The Bylaws vest all corporate powers and control of the business affairs of the Company in a Board of Directors. On February 23, 1993, an amendment was approved, increasing the number of Directors from five (5) to eight (8). Not less than three-fourths of the Board of Directors shall be United States citizens, as required by RCW 48.07.050. Directors of the Company need not be citizens of the State of Washington nor shareholders of the corporation.

The financial controls and operations of the Company are under the direction of Donald Sirkin, Chairman of the Board and Chief Executive Officer since 1984. Previously he served as President of CBIC since inception of the Company. Mr. Sirkin owns 98% of Data and Staff Service Company, the parent company, and is also the Chairman and Chief Executive Officer of DSSC.

The President of the Company, Steven Allen Gaines, has served since April 1, 1984. Previously, he served as Secretary since 1979.

The following directors and officers are serving the Company as of December 31, 1996:

Officers:

Donald Sirkin	Chief Executive Officer
Steven A. Gaines	President
Marc A. Mrkvicka	Chief Financial Officer, Assistant Secretary
Kevin L. Lybeck	Secretary, Senior Vice President
R. Kirkpatrick Eland	Treasurer

Contractors Bonding and Insurance Company

Clark P. Graves	Vice President - Information Technology
Ron Rice	Vice President - Marketing
J.D. Minto	Vice President
Larry Byers	Vice President
Jay Malone	Vice President
Tom Dymont	Vice President
Charles J. Falskow	Vice President
John Pieprzny	Vice President
Richard S. Bak	Vice President
Constance Rodriguez	Assistant Vice President
Bonnie M. Heitman-Pierson	Assistant Vice President
Debbie J. Kidd	Assistant Vice President

Directors:

<u>Name</u>	<u>Principal Occupation</u>
Donald Sirkin (Chairman)	Chief Executive Officer of DSSC
Steven A. Gaines	Secretary of DSSC
Marc A. Mrkvicka	President of DSSC
Darrel L. Hallett	Attorney, Chicoine & Hallett, P.S.
James R. Dickens	Attorney, Miller, Nash, Wiener, Hager & Carlson
Matthew M. Kelleher	Vice President - Paine Webber, Inc.
R. Kirkpatrick Eland	Treasurer of DSSC
Eric R. Sirkin	

AFFILIATED COMPANIES

Data and Staff Service Company

Data and Staff Service Company, a domestic insurance holding company, is the parent of CBIC. Donald Sirkin, Chairman and Chief Executive Officer, owns 98% of the outstanding shares of DSSC. The remaining 2% of the outstanding shares of DSSC is owned by the Employee Stock Ownership Plan (ESOP).

On September 1, 1990, CBIC entered into a Ground Lease Agreement with DSSC and Donald Sirkin. CBIC pays \$16,666 per month, which is being split between DSSC and Mr. Sirkin in proportion to the square footage owned by each to the total square footage.

On January 4, 1994, CBIC adopted certain corporate resolutions which amended the Consolidated Tax Agreement with DSSC to meet statutory requirements for the State of New York which were needed to become licensed in that state. The agreement states that federal income taxes will be calculated on the 'separate return method' as required by the National Association of Insurance Commissioners (NAIC). However, the agreement did not include the signature of an officer of DSSC, indicating acceptance of the agreement. On April 22, 1998, subsequent to the examination date, the Consolidated Tax Agreement was revised and signed by officers of both companies to include the signatures of both parties.

The Gaines Law Firm

Contractors Bonding and Insurance Company

Although not directly affiliated through ownership ties, it is recognized that Steven A. Gaines, President and Director of CBIC is also the controlling stockholder of The Gaines Law Firm (TGLF).

Prior to 1996 a significant amount of the contract bond legal work and legal corporate affairs of the Company was conducted by lawyers and personnel of TGLF. TGLF's retainer was reviewed and ratified by the Company's Board of Directors. Beginning January 1, 1996 all personnel of TGLF became employees of the CBIC and TGLF went inactive and terminated the retainer relationship with the Company.

CAPITAL AND SURPLUS

Contractors Bonding and Insurance Company has 1,000,000 authorized shares of \$10.00 par value, voting, common stock. As of December 31, 1996, 235,000 shares of common stock were outstanding, with a value of \$2,350,000. Additional Gross Paid In and Contributed Surplus was \$1,510,250. The total paid in capital stock and additional surplus equaled \$3,860,250, exceeding the minimum requirements set forth in RCW 48.05.340. All of the outstanding shares of CBIC are wholly-owned by the parent company, Data and Staff Service Company.

CORPORATE RECORDS

The examiners reviewed the corporate records of Contractors Bonding and Insurance Company for the period under examination. All Board meetings were conducted with a quorum present. The Board members ratified all changes to the Articles of Incorporation and Bylaws.

ACCOUNTING RECORDS AND PROCEDURES

The Company maintains its accounting records on a GAAP modified accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for Annual Statement reporting. The Company is audited annually by the Certified Public Accountants, Ernst & Young, LLP, and that firm issued its unqualified opinion for the year ending December 31, 1996.

Unpaid Losses and Loss Adjustment Expenses

The reserves carried by the Company for Unpaid Losses was \$6,211,203 and the reserves for Loss Adjustment Expenses was \$1,454,515, as of December 31, 1996.

These reserves were reviewed by the Property & Casualty actuarial staff employed by the Office of Insurance Commissioner (OIC). The Company provided Losses and Loss Adjustment Expenses development data by line of business. The OIC actuarial staff obtained additional information by interviewing several Company employees and by reviewing actuarial reports prepared by the Company's consulting actuarial firm, Ernst &

Contractors Bonding and Insurance Company

Young, LLP.

The estimates of the OIC actuarial staff indicate that reserves for Losses and Loss Adjustment expenses, on a net basis, are within a reasonable range. Therefore, these reserves are accepted as they appear in the Company's 1996 Annual Statement.

INTERNAL SECURITY

Conflict of Interest

Contractors Bonding and Insurance Company has a policy statement and questionnaire for the disclosure of conflicts of interest and requires all directors, officers and key employees to sign the statement annually. The signed statements are reviewed annually for conflicting situations. The Board of Directors annually review the statements of Donald Sirkin, Chief Executive Officer and Steven A. Gaines, President and any other statements that may contain conflicting situations.

A review of the 1996 statements noted the Company did not have on file a signed statement from one (1) of its officers. It was not possible to determine if the statement was misfiled or not submitted. The Company does have on file signed statements from the officer for the years 1992 through 1995, 1997 and 1998.

Fidelity Bond and Other Insurance

The Company is a named insured on an extensive portfolio of insurance which appears to cover against all catastrophic and other losses. C. Don Filer Agency, Inc. is the insurance broker for the Company, as well as for Data and Staff Service Company. The NAIC suggested minimum amounts of fidelity insurance were calculated at a minimum of \$400,000 - \$450,000. The Company carries \$400,000 which is adequate to meet the minimum guidelines.

St. Paul Fire and Marine Insurance Company

National Union Fire Insurance

Commercial General Liability

April 16, 1996 - April 16, 1997

Includes personal business property and buildings. The following summarizes the policy limits and deductibles:

Products/completed operations aggregate	\$1,000,000
General aggregate	1,000,000
Bodily injury and property damage liability (any one occurrence)	1,000,000
Fire damage liability (any one fire)	50,000
Medical payments (any one person)	5,000
Deductibles	1,000

Commercial Excess Liability

April 16, 1996 - April 16, 1997

Each Occurrence	\$10,000,000
General aggregate	10,000,000

Contractors Bonding and Insurance Company

Workers Compensation & Employers Liability March 10, 1996 - March 10, 1997

Each Accident	\$1,000,000
Disease - Policy Limit	1,000,000
Disease - Each Employee	1,000,000

Crime	April 16, 1996 - April 16, 1997
Limit	\$400,000
Deductible	10,000

St. Paul Fire and Marine Insurance Company

Financial Institution Bond	April 16, 1996 - April 16, 1997
Single Loss Limit of Liability	\$400,000
Single Loss Deductible	10,000

New Hampshire Insurance Company

Employment Related Practices Liability	August 29, 1996 - August 29, 1997
Total Limit	\$2,000,000
Each Insured Event Limit	2,000,000
Deductible	25,000

Agricultural Excess and Surplus Insurance Company

Professional Liability	August 29, 1996 - August 29, 1997
Aggregate Limit of Liability	\$2,000,000
Deductible	250,000

Columbia Casualty Company

Employed Lawyers Professional Liability	October 1, 1996 - October 1, 1997
Maximum Aggregate Limit of Liability	\$1,000,000
Deductible per Claim	5,000

EMPLOYEE RELATIONS AND WELFARE

The Company offers to all employees meeting certain eligibility requirements the following employee benefits at no cost to the employee. Employees are responsible for the additional costs of spouses and dependants:

- Medical Insurance
- Dental Insurance
- Long Term Disability Insurance
- Group Term Life and Accidental Death & Disability Insurance

Data and Staff Service Company Profit Sharing Plan

The parent company offers a qualified defined contribution profit sharing plan which covers substantially all CBIC employees meeting certain eligibility requirements. Under the plan, there is no fixed dollar amount of retirement benefits. Each year the employer may elect to

Contractors Bonding and Insurance Company

make a Discretionary Contribution to the plan in such amount, if any, as determined annually by the employer. Actual benefits to participants depend upon the value of vested Account Balances at the time of retirement, based on a formula which includes credited years of service.

For year end 1996, the plan was audited by Moss Adams, LLP, and that firm issued its unqualified opinion. The fair value of the plan assets was \$3,534,092 as of December 31, 1996.

Data and Staff Service Company Employee Stock Ownership Plan

The parent company maintains an Employee Stock Ownership Plan which covers substantially all CBIC employees meeting certain eligibility requirements. The purpose of the plan is to reward eligible employees for long and loyal service. The plan is governed by the Employee Retirement Income Security Act of 1974 (ERISA), as amended, and the laws of the State of Washington. Plan assets are invested primarily in common stock of DSSC. Each year the employer determines the amount, if any, of its contribution to the plan. Actual retirement benefits depend upon the accumulated value of the eligible employee's account, based on a formula which includes the participant's compensation.

In June 1995, the plan received a favorable determination letter from the Internal Revenue Service. The letter states:

The plan satisfies the nondiscrimination in amount requirement of section 1.401(a)(4)-1(b)(2) of the Income Tax Regulations on the basis of a design-based safe harbor described in the regulations.

The plan satisfies the nondiscriminatory current availability requirements of section 1.401(a)(4)-4(b) of the Income Tax Regulations with respect to those benefits, rights, and features that are currently available to all employees in the plan's coverage group.

For year end 1996, the allocation of plan investments to participant accounts was prepared by Howard Johnson & Company, who relied upon employee and financial data furnished by the Company. Accordingly, they do not accept responsibility for the accuracy of the data. The fair value of the plan assets was \$587,121 as of December 31, 1996.

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TERRITORY AND PLAN OF OPERATIONS

At the completion of the previous examination, as of December 31, 1991, CBIC was licensed in forty-eight (48) states and the District of Columbia. During the current examination period, CBIC obtained Certificates of Authority from New Hampshire and New York and now is admitted in all fifty (50) states. Due to the Company's recent initiative to expand into non-surety commercial property and casualty lines of business, the Company has amended a number of its Certificates to obtain authority to write such lines. This process will continue as the Company ventures into more states where authority has not already been obtained.

CBIC expects that most of its premium growth in the next few years will be from the new commercial property and casualty lines and is presently writing these lines in seven (7) states. Steps to expand into additional states will be taken only when it is considered cost justifiable by management.

EDP SYSTEMS AND OPERATIONS

The Management of CBIC is sufficiently knowledgeable of EDP issues and provides direction and oversight through its Steering Committee. Systems Development, Acquisition and Maintenance Controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. Due to the small size of the Company, there are numerous areas where separation of duties is not possible. In those instances, the Company has stepped up its review and oversight by management. As the Company grows and its staff size increases, changes will be implemented to allow proper separation of duties. The Company has long-term plans to upgrade its IBM AS/400 to increase capacity.

Operations and Application Controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed and the controls exercised to maintain data security. Adequate procedures and controls are in place for network operations, PC's and Year 2000 issues. The Company is on schedule for becoming Year 2000 compliant by year end 1998.

GROWTH OF COMPANY

The following schedules reflect the growth of the Company by year beginning in 1992. The amounts shown were compiled from the Company's filed Annual Statements:

Contractors Bonding and Insurance Company

Schedule 1

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
1996	\$49,141,795	\$28,694,632	\$20,447,163
1995	44,620,167	25,842,609	18,777,558
1994	43,185,868	26,082,178	17,103,690
1993	42,104,429	25,457,029	16,647,400
1992	39,340,303	23,408,094	15,932,209

Schedule 2

<u>Year</u>	<u>Net Premiums Written</u>	<u>Investment Income</u>	<u>Underwriting Deductions</u>
1996	\$23,521,743	\$2,155,394	\$18,277,982
1995	19,161,215	2,135,810	17,628,889
1994	18,101,862	1,570,915	17,644,358
1993	20,271,174	1,739,513	19,941,066
1992	20,223,810	2,018,915	16,931,272

REINSURANCE

During 1996, CBIC ceded premiums of \$4,485,224, which equaled approximately 16% of the Total Direct Written Premiums. The principle reinsurers are American Re-Insurance Company, Munich American Reinsurance Company, NAC Reinsurance Company, Kemper Reinsurance Company and First Excess Reinsurance Company. Each of these companies are authorized reinsurers in the State of Washington. The terms of the reinsurance agreements in effect for 1996 are:

	<u>Coverage Limits</u>
Excess of Loss on Surety	85% of \$5,800,000 in excess of \$200,000
Quota Share Treaty on Selected Surety Risks	\$10,000,000
Excess of Loss on Casualty Risks	\$1,925,000 in excess of \$75,000
Aggregate/Occurrence	\$2,775,000
Excess of Loss on Property Risks	\$925,000 in excess of \$75,000
Aggregate/Occurrence	\$2,775,000
Quota Share Treaty on Property Risks	90% of \$2,000,000 any one occurrence
Catastrophe Treaty on Property Risks	\$1,000,000 excess of \$300,000
(Effective 07/01/96 to 12/31/96)	\$95% of \$5,000,000 excess of \$6,000,000
Clash on Property	\$1,000,000 excess of \$1,000,000

Contractors Bonding and Insurance Company

SUBSEQUENT EVENTS

On May 9, 1997, the Board of Directors approved the issue of a stock dividend to its sole shareholder, Data and Staff Service Corporation, of 15,000 common shares, \$10 par value. After the issuance, the number of shares issued and outstanding equaled 250,000, each with a par value of \$10 and a total stated capital of \$2,500,000. Unassigned surplus was correspondingly reduced by the sum of \$150,000.

During the examination of the invested assets, it was noted that the Custodial Agreement did not include an indemnification clause requiring the bank to reimburse the Company for the loss of securities, as required by the NAIC. This requirement was brought to the attention of the Company and during February 1998, the Company amended the Custodial Agreement to include the required indemnification clause. The amendment was signed by officers of the bank and CBIC.

During the examination of Federal and Foreign Income Taxes, it was noted that the Tax Sharing Agreement with Data and Staff Service Company did not include the signature of an officer of DSSC. The lack of a signature was brought to the attention of the Company and on April 22, 1998, the Company amended the Tax Sharing Agreement to include the signatures of an officer from both companies.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The previous examination report, as of December 31, 1991, included the following Comments and Recommendations. The Company has complied with each recommendation.

1. Real Estate Occupied By The Company

The NAIC guidelines require insurers occupying its own building, in whole or in part, to include an adequate amount of rent expense for the rent of its own occupancy. The Company did not report real estate income and office rent for its own occupancy in 1990 and 1991. It is recommended that the Company compute real estate income and office rent for its own occupancy.

A review of the general ledger real estate income and office rent accounts noted that the Company has complied with this recommendation. During 1996, the Company recorded \$21,000 per month as real estate income and rental expense, as required by NAIC guidelines.

2. Cash on Hand

The Company should adopt a policy and procedure regarding the disposition of old outstanding checks. After a certain period of time, old outstanding checks should be transferred to a liability account for unclaimed funds. After the prescribed time period, the unclaimed funds should be reported to various states in accordance with the Escheat laws.

A review of the liability accounts noted that the Company has complied with this

Contractors Bonding and Insurance Company

recommendation. During 1996, the Company reported a liability of \$808 for unclaimed properties.

3. Other Expenses

Real estate expenses and taxes were allocated to Loss Adjustment and Underwriting expenses instead of Investment Expenses exclusively. It is recommended that the expense allocation be corrected.

A review of the 1996 Underwriting and Investment Exhibit Part 4 - Expenses noted that the Company has complied with this recommendation and reported the real estate expenses and taxes exclusively as Investment Expenses.

4. Fidelity Coverage

Fidelity coverage was found not to be within the NAIC minimum limits. The Company needs to increase its coverage in order to attain this limit. It is recommended that the Company increase its fidelity coverage to comply with the NAIC recommended limit.

A review of the fidelity coverage noted that the Company has complied with this recommendation. During 1996, the Company's fidelity coverage limit was \$400,000, which is within the NAIC recommended level of \$400,000 - \$450,000.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Contractors Bonding and Insurance Company as of December 31, 1996:

Statement of Assets, Liabilities, Surplus and Other Funds
Underwriting and Investment Exhibit
Comparative Statement of Assets, Liabilities, Surplus and Other Funds
Comparative Underwriting and Investment Exhibit
Five Year Reconciliation of Capital and Surplus Account

No examination adjustments or reclassifications were required for the examination financial statements.

CONTRACTORS BONDING AND INSURANCE COMPANY

Statement of Assets, Liabilities, Surplus and Other Funds

As of December 31, 1996

	Balance Per Company	Ref.	Examination Adjustments	Balance Per Examination
ASSETS				
Bonds	\$ 31,146,103			\$ 31,146,103
Stocks:				
Common stocks	4,154,886			4,154,886
Real Estate:				
Properties occupied by the company	2,758,794			2,758,794
Cash	7,114,318			7,114,318
Subtotals, cash and invested assets	45,174,101		0	45,174,101
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	1,147,859			1,147,859
Premiums, agents' balances and installments booked but deferred and not yet due	1,702,371			1,702,371
Reinsurance recoverables on loss and loss adjustment expense payments	25,831			25,831
Electronic data processing equipment	577,253			577,253
Interest, dividends and real estate income due and accrued	514,380			514,380
Total Assets	\$ 49,141,795		0	\$ 49,141,795
LIABILITIES				
Losses	\$ 6,211,203			\$ 6,211,203
Loss adjustment expenses	1,454,515			1,454,515
Contingent commissions and other similar charges	30,527			30,527
Other expenses (excluding taxes, licenses and fees)	1,159,285			1,159,285
Taxes, licenses and fees (excluding federal and foreign income taxes)	160,243			160,243
Federal and foreign income taxes	373,492			373,492
Unearned premiums	12,429,464			12,429,464
Funds held by company under reinsurance treaties	27			27
Amounts withheld or retained by company for accounts of others	6,725,241			6,725,241
Excess of statutory reserves over statement reserves	36,000			36,000
Payable to parent, subsidiaries and affiliates	114,635			114,635
Total Liabilities	28,694,632		0	28,694,632
SURPLUS AND OTHER FUNDS				
Common capital stock	2,350,000			2,350,000
Gross paid in and contributed surplus	1,510,250			1,510,250
Unassigned funds (surplus)	16,586,913			16,586,913
Surplus as regards policyholders	20,447,163		0	20,447,163
Total Liabilities, Surplus and Other Funds	\$ 49,141,795		0	\$ 49,141,795

CONTRACTORS BONDING AND INSURANCE COMPANY

Underwriting and Investment Exhibit

Statement of Income

For the Year Ended December 31, 1996

	Balance Per Company	Ref.	Examination Adjustments	Balance Per Examination
UNDERWRITING INCOME				
Premiums earned	\$ 20,920,512			\$ 20,920,512
DEDUCTIONS				
Losses incurred	1,892,438			1,892,438
Loss expenses incurred	837,432			837,432
Other underwriting expenses incurred	<u>15,548,112</u>			<u>15,548,112</u>
Total underwriting deductions	<u>18,277,982</u>		<u>0</u>	<u>18,277,982</u>
Net underwriting gain or (loss)	2,642,530		0	2,642,530
INVESTMENT INCOME				
Net investment income earned	2,030,104			2,030,104
Net realized capital gains or (losses)	<u>125,290</u>			<u>125,290</u>
Net investment gain or (loss)	2,155,394		0	2,155,394
OTHER INCOME				
Net gain or (loss) from agents' or premium balances charged off	(29,303)			(29,303)
Aggregate write-ins for miscellaneous income	<u>2,645</u>			<u>2,645</u>
Total other income	<u>(26,658)</u>		<u>0</u>	<u>(26,658)</u>
Net income before dividends to policyholders and before federal and foreign income taxes	4,771,266		0	4,771,266
Dividends to policyholders	<u>0</u>			<u>0</u>
Net income, after dividends to policyholders but before federal and foreign income taxes	4,771,266		0	4,771,266
Federal and foreign income taxes incurred	<u>1,736,125</u>			<u>1,736,125</u>
Net Income	<u>\$ 3,035,141</u>		<u>0</u>	<u>\$ 3,035,141</u>
CAPITAL AND SURPLUS ACCOUNT				
Surplus as regards policyholders, December 31 prior year	\$ 18,777,558			\$ 18,777,558
GAINS AND (LOSSES) IN SURPLUS				
Net income	3,035,141		0	3,035,141
Net unrealized capital gains or (losses)	270,573			270,573
Change in nonadmitted assets	192,037			192,037
Change in excess of statutory reserves over statement reserves	(36,000)			(36,000)
Dividends to stockholders	(1,550,000)			(1,550,000)
Aggregate write-ins for gains and losses in surplus	<u>(242,146)</u>			<u>(242,146)</u>
Change in surplus as regards policyholders for the year	<u>1,669,605</u>		<u>0</u>	<u>1,669,605</u>
Surplus as regards policyholders, December 31 current year	<u>\$ 20,447,163</u>		<u>0</u>	<u>\$ 20,447,163</u>

CONTRACTORS BONDING AND INSURANCE COMPANY
Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,

	1996.	1995
ASSETS		
Bonds	\$ 31,146,103	\$ 30,776,867
Stocks:		
Common stocks	4,154,886	\$ 4,014,144
Real Estate:		
Properties occupied by the company	2,758,794	\$ 2,867,467
Cash	<u>7,114,318</u>	<u>3,832,680</u>
Subtotals, cash and invested assets	45,174,101	41,491,158
Agents' balances or uncollected premiums:		
Premiums and agents' balances in course of collection	1,147,859	220,026
Premiums, agents' balances and installments booked but deferred and not yet due	1,702,371	1,279,836
Reinsurance recoverables on loss and loss adjustment expense payments	25,831	518,153
Electronic data processing equipment	577,253	623,332
Interest, dividends and real estate income due and accrued	<u>514,380</u>	<u>487,662</u>
Total Assets	<u>\$ 49,141,795</u>	<u>\$ 44,620,167</u>
LIABILITIES		
Losses	\$ 6,211,203	\$ 5,363,380
Loss adjustment expenses	1,454,515	1,391,524
Contingent commissions and other similar charges	30,527	14,275
Other expenses (excluding taxes, licenses and fees)	1,159,285	978,479
Taxes, licenses and fees (excluding federal and foreign income taxes)	160,243	130,463
Federal and foreign income taxes	373,492	500,354
Unearned premiums	12,429,464	9,828,233
Funds held by company under reinsurance treaties	27	27
Amounts withheld or retained by company for accounts of others	6,725,241	7,566,812
Excess of statutory reserves over statement reserves	36,000	-
Payable to parent, subsidiaries and affiliates	<u>114,635</u>	<u>69,062</u>
Total Liabilities	28,694,632	25,842,609
SURPLUS AND OTHER FUNDS		
Common capital stock	2,350,000	2,350,000
Gross paid in and contributed surplus	1,510,250	1,510,250
Unassigned funds (surplus)	<u>16,586,913</u>	<u>14,917,308</u>
Surplus as regards policyholders	<u>20,447,163</u>	<u>18,777,558</u>
Total Liabilities, Surplus and Other Funds	<u>\$ 49,141,795</u>	<u>\$ 44,620,167</u>

CONTRACTORS BONDING AND INSURANCE COMPANY

Comparative Summary of Operations

For the Years Ended December 31,

	1996.	1995
<u>UNDERWRITING INCOME</u>		
Premiums earned	\$ 20,920,512	\$ 18,548,173
DEDUCTIONS		
Losses incurred	1,892,438	2,560,854
Loss expenses incurred	837,432	688,294
Other underwriting expenses incurred	<u>15,548,112</u>	<u>14,379,741</u>
Total underwriting deductions	<u>18,277,982</u>	<u>17,628,889</u>
Net underwriting gain or (loss)	2,642,530	919,284
<u>INVESTMENT INCOME</u>		
Net investment income earned	2,030,104	1,955,895
Net realized capital gains or (losses)	<u>125,290</u>	<u>179,915</u>
Net investment gain or (Loss)	2,155,394	2,135,810
<u>OTHER INCOME</u>		
Net gain or (loss) from agents' or premium balances charged off	(29,303)	(74,700)
Aggregate write-ins for miscellaneous income	<u>2,645</u>	<u>691</u>
Total other income	<u>(26,658)</u>	<u>(74,009)</u>
Net income before dividends to policyholders and before federal and foreign income taxes	4,771,266	2,981,085
Dividends to policyholders	<u>0</u>	<u>0</u>
Net income, after dividends to policyholders but before federal and foreign income taxes	4,771,266	2,981,085
Federal and foreign income taxes incurred	1,736,125	910,354
Net Income	<u>\$ 3,035,141</u>	<u>\$ 2,070,731</u>

CONTRACTORS BONDING AND INSURANCE COMPANY
Five Year Reconciliation of Capital and Surplus Account
As of December 31,

	1996	1995	1994	1993	1992
CAPITAL AND SURPLUS ACCOUNT					
Surplus as regards policyholders, December 31, prior year	\$ 18,777,558	\$ 17,103,690	\$ 16,647,400	\$ 15,932,209	\$ 10,098,603
GAINS AND (LOSSES) IN SURPLUS					
Net income	3,035,141	2,070,731	1,464,133	1,168,768	2,979,038
Net unrealized capital gains or (losses)	270,573	850,611	(231,668)	178,286	112,050
Change in nonadmitted assets	192,037	(127,773)	58,624	(85,863)	(86,482)
Change in provision for reinsurance		299	(299)		
Change in excess of statutory reserves over statement reserves	(36,000)				
Dividends to stockholders	(1,550,000)	(1,120,000)	(834,500)	(546,000)	(581,000)
Aggregate write-ins for gains and losses in surplus	<u>(242,146)</u>				<u>3,410,000</u>
Change in surplus as regards policyholders for the year	<u>1,669,605</u>	<u>1,673,868</u>	<u>456,290</u>	<u>715,191</u>	<u>5,833,606</u>
Surplus as regards policyholders, December 31 current year	<u>\$ 20,447,163</u>	<u>\$ 18,777,558</u>	<u>\$ 17,103,690</u>	<u>\$ 16,647,400</u>	<u>\$ 15,932,209</u>

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting Policies

- A. Basis of presentation
The financial statements included herein have been prepared in accordance with accounting practices prescribed or permitted by the Office of Insurance Commissioner of the State of Washington and with the NAIC Financial Examiners Handbook.
- B. Investments
Investments are valued based on the NAIC's Valuation of Securities Manual. Bonds are valued at amortized cost. Common stocks are valued at market value.
- C. Property, Furniture and Equipment
Buildings, office furniture and computer equipment are recorded at cost. Depreciation is computed on a straight line basis over the estimated life, thirty-one and one-half (31.5) years for the building and five (5) years for furniture and equipment.
- D. Underwriting expense
Underwriting costs such as commissions and general insurance expense are written off in the year incurred and not deferred and amortized against future earning.
- E. Income Taxes
Taxable income differs from statutory income due to capitalization of policy acquisition expenses, discounting of policy reserves and utilization of net operating loss and tax carry forwards.
- F. Parent, Subsidiaries and Affiliates
The Company is a wholly-owned subsidiary of Data and Staff Service Company. The Company paid common stock dividends of \$1,550,000 and ground rent of \$160,000 to its parent in 1996.
- G. Non-admitted assets
Certain assets designated as "non-admitted," which consist of furniture and equipment and prepaid expenses, have been excluded from the balance sheet. The non-admitted assets are reflected as direct adjustments from net worth. The total non-admitted assets as of December 31, 1996 amounted to \$571,929.
- H. Reinsurance
Accruals and reserves for surety bonds, property and casualty policies, premium revenues and policy benefits are reported net of reinsurance in the financial statements.

Contractors Bonding and Insurance Company

2. Bonds

Amortization of bond discounts and premiums is accrued using the effective interest method over the remaining term of the bonds. The statement value, unrealized gains and losses, estimated market values and acquisition cost of securities held for investment as of December 31, 1996 were as follows:

	Amortized <u>Value</u>	Unrealized Gains/ <u>(Losses)</u>	Market <u>Value</u>	Actual <u>Cost</u>
Government	\$20,761,873	\$228,826	\$20,990,699	\$20,833,648
States, Terr. & Poss.	815,882	651	816,533	809,413
Political Subdivisions	2,759,264	40,306	2,799,570	2,794,325
Special Revenue	<u>6,809,084</u>	<u>135,066</u>	<u>6,944,150</u>	<u>6,791,555</u>
Total	<u>\$31,146,103</u>	<u>\$404,849</u>	<u>\$31,550,952</u>	<u>\$31,228,941</u>

The maturity distribution of all bonds owned as of December 31, 1996 was as follows:

	Amortized <u>Value</u>	Percent of <u>Portfolio</u>
Due in one year or less	\$5,315,680	17.1%
Due over one year through five years	17,151,648	55.0%
Due over five years through ten years	6,660,978	21.4%
Due over ten years through twenty years	2,017,797	6.5%
Over twenty years	<u>0</u>	<u>0.0%</u>
Total	<u>\$31,146,103</u>	<u>100.0%</u>

The Securities Valuation Office classification distribution as of December 31, 1996 was as follows:

	Amortized <u>Value</u>	Percent of <u>Portfolio</u>
Class 1	\$31,146,103	100.0%
Total	<u>\$31,146,103</u>	<u>100.0%</u>

3. Common Stocks

The Book Value, Unrealized Gains and Losses, Estimated Market Values and Actual Cost of common stocks held as of December 31, 1996 were as follows:

	Book <u>Value</u>	Unrealized Gains/ <u>(Losses)</u>	Market <u>Value</u>	Actual <u>Cost</u>
Common Stocks	\$2,666,528	\$1,488,358	\$4,154,886	\$2,666,528

Contractors Bonding and Insurance Company

4. Real Estate: Properties Occupied By The Company

Real Estate held for Company use consists of the home office building. The Cost and Accumulated Depreciation as of December 31, 1996 were as follows:

Real Estate at Cost	\$3,414,646
Accumulated Depreciation	<u>(655,852)</u>
Total Real Estate	<u>\$ 2,758,794</u>

5. Cash

The reported balances for Cash On Hand And On Deposit and Short-Term Investments as of December 31, 1996 were as follows:

Cash on hand and on deposit	\$2,266,122
Short-Term Investments	<u>4,848,196</u>
Total Cash	<u>\$ 7,114,318</u>

6. Aggregate Write-Ins For Other Than Invested Assets

Aggregate Write-Ins For Other Than Invested Assets as of December 31, 1996 consisted of the following assets. These assets were properly reported as Non-Admitted Assets and the Balance Per Examination equals zero.

Prepaid Expenses	\$69,932
Advances to Employees	<u>1,387</u>
Total reserve	<u>\$71,319</u>

7. Loss Reserves

Surety bonds and property and casualty policies had the following reserves for the year ending December 31, 1996:

Surety	\$5,358,299
Property and Casualty	<u>852,904</u>
Total Loss Reserve	<u>\$6,211,203</u>

Contractors Bonding and Insurance Company

8. Net Investment Income

The following is a summary of net investment income earned for the year ending December 31, 1996:

Bonds	\$1,871,856
Common Stock	154,463
Real Estate	252,000
Cash on hand and on deposit	94,452
Short-term investments	<u>173,854</u>
Gross investment income	2,546,625
Investment expenses	<u>(516,521)</u>
Net Investment Income	<u>\$2,030,104</u>

9. Aggregate Write-Ins For Miscellaneous Income

Aggregate Write-Ins For Miscellaneous Income as of December 31, 1996 consisted of the following item:

Gain on sale of computer equipment	<u>\$2,645</u>
Total	<u>\$2,645</u>

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Contractors Bonding and Insurance Company during the course of this examination.

In addition, acknowledgment is made of the participation in the work and preparation to this report by John R. Jacobson, AFE, Examiner-in-Charge; Kendy Ovbiebo; Lee Barclay, FCAS; Joshua Ligosky; all from the Washington Office of Insurance Commissioner.

Contractors Bonding and Insurance Company

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
COUNTY OF KING }

John R. Jacobson, AFE, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Contractors Bonding and Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

John R. Jacobson, AFE
Examiner-in-charge
State of Washington

Subscribed and sworn to before me this ____ day of _____, 1998.

Notary Public in and for the
State of Washington.